

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 LYNWOOD D. HALL, ET UX., :

4 Petitioners : No. 10-875

5 v. :

6 UNITED STATES :

7 - - - - - x

8 Washington, D.C.

9 Tuesday, November 29, 2011

10

11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States
13 at 10:03 a.m.

14 APPEARANCES:

15 SUSAN M. FREEMAN, ESQ., Phoenix, Arizona; for
16 Petitioners.

17 PRATIK A. SHAH, ESQ., Assistant to the Solicitor

18 General, Department of Justice, Washington, D.C.; for
19 Respondent.

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1 P R O C E E D I N G S

2 (10:03 a.m.)

3 CHIEF JUSTICE ROBERTS: We'll hear argument
4 first this morning in Case 10-875, Hall v. United
5 States.

6 Ms. Freeman.

7 ORAL ARGUMENT OF SUSAN M. FREEMAN

8 ON BEHALF OF THE PETITIONERS

9 MS. FREEMAN: Mr. Chief Justice, and may it
10 please the Court:

11 Bankruptcy estates incur taxes when they
12 generate income. The Government's attempt to limit the
13 effect of the farm sale statute, section 1222(a)(2)(A),
14 alters that fundamental principle in corporate chapter
15 11 cases and in all bankruptcy cases, as it requires
16 this Court to construe the administrative section and
17 the priority section of the Bankruptcy Code that do
18 apply in all of those cases.

19 In a chapter 12 case, the bankruptcy estate
20 consists of more than just the assets that existed as of
21 the date of filing. They also consist of all of the
22 income that is earned thereafter, wages -- Mrs. Hall's
23 wages as a convenience store clerk are part of the
24 bankruptcy estate -- the proceeds from selling crops --

25 JUSTICE KENNEDY: Does it include debts

1 incurred after the filing?

2 MS. FREEMAN: From the period -- from the
3 petition filing date until the confirmation of the plan,
4 yes, it does. Those debts are incurred in the operation
5 of the estate --

6 JUSTICE KENNEDY: Debts -- debts that were
7 incurred after that date?

8 MS. FREEMAN: Yes, Your Honor. So that, for
9 example, in operating an estate, you would incur a light
10 bill as well as incurring taxes. All of the operating
11 expenses are incurred by the bankruptcy estate and are
12 payable from the income and from the estate assets
13 during that period from the petition filing date until
14 the confirmation of the plan.

15 JUSTICE GINSBURG: Is that true of --

16 MS. FREEMAN: That's the administrative
17 period.

18 JUSTICE GINSBURG: Is that true of State --
19 you said taxes. Is it true of State taxes?

20 MS. FREEMAN: Yes, Your Honor, it is true of
21 State taxes as well as Federal taxes. County taxes, for
22 example. Property taxes --

23 JUSTICE GINSBURG: So, in this -- in this --
24 we're dealing with a capital gains tax on the sale of
25 the farm. Suppose a State had a similar tax; it also

1 taxed the gain on the sale.

2 MS. FREEMAN: Correct, Your Honor, and it
3 did in this particular case. So, there would be State
4 taxes on the capital gains, and those would also be
5 administrative expense priorities, except for the farm
6 sale provision here, which demotes that priority if the
7 debtor is able to earn a discharge. And if so, then
8 those farm sale taxes are demoted in priority and may be
9 discharged under a plan of reorganization. They would
10 share pro rata with the other prepetition claims of the
11 bankruptcy estate.

12 JUSTICE ALITO: Who would file the State tax
13 return? Would it be filed by the estate or would it be
14 filed by the debtor?

15 MS. FREEMAN: The debtor and the estate are
16 one in a -- in a reorganization case. And so, the
17 taxpayers, Lynwood and Brenda Hall, would file the tax
18 return. The way that it would actually be administered,
19 Your Honor, is shown by the Knudsen case. And,
20 basically, there would be a tax return that includes all
21 of the income, the wages, the crop sale proceeds and so
22 forth. And then it would compute it with the capital
23 gains tax, and there would be a separate pro forma
24 return that does not include the capital gains tax.

25 Those would be sent to the Special

1 Procedures Unit of the IRS, so that somebody there would
2 know how to deal with it and would be able to count the
3 difference.

4 JUSTICE SOTOMAYOR: Counsel, how do you deal
5 with section 346?

6 MS. FREEMAN: Section 346, Your Honor,
7 basically makes the State taxes consistent with the
8 Federal taxes. When you have --

9 JUSTICE SOTOMAYOR: I read 346(b) to say
10 that, unless the estate is a separate tax entity under
11 the code, that the debtor, not the estate, pays State
12 and local taxes. This is totally contrary to what
13 you're saying, but the language of 346(b) --

14 MS. FREEMAN: Your Honor --

15 JUSTICE SOTOMAYOR: -- basically answers the
16 question against you with respect to State and local
17 taxes.

18 MS. FREEMAN: Justice Sotomayor, I do not
19 think it does, in the sense -- in this sense: The
20 bankruptcy -- section 346(b) made the State and local
21 taxes consistent with Federal taxes, and when you have a
22 bankruptcy estate that consists only of assets on the
23 petition filing date, then you have a separate taxable
24 entity with a separate tax I.D. number that is set up.
25 But under the Federal bankruptcy -- under the Federal

1 tax code, under section 1399, whenever the bankruptcy
2 estate had income during the course of the estate,
3 during the administration period, as well as the assets
4 on the petition filing date, then it's a single taxable
5 entity. And so, that single taxpayer would pay it.

6 Section 346 doesn't say what assets are used
7 to pay the tax. That's a matter of bankruptcy law. The
8 debtor, the individual taxpayer, is going to file the
9 tax return under State and local and Federal law, but
10 he's going to use the estate assets because that's all
11 there is. He doesn't have any other assets.

12 JUSTICE SOTOMAYOR: So, the debtor is going
13 to pay.

14 MS. FREEMAN: The debtor pays --

15 JUSTICE SOTOMAYOR: And so, when this says
16 whenever the Internal Revenue Code of 1986 provides that
17 no separate taxable estate shall be created in a case
18 concerning a debtor under this title --

19 MS. FREEMAN: Right.

20 JUSTICE SOTOMAYOR: -- chapter 12 doesn't
21 create a separate taxable estate.

22 MS. FREEMAN: Correct.

23 JUSTICE SOTOMAYOR: And that the income,
24 et cetera, shall be taxed to or claimed by the debtor
25 under State or local law.

1 MS. FREEMAN: That's correct, Your Honor.
2 It's going to be on the debtor's tax return. The
3 debtor's the one who will have the deductions, and the
4 deductions would include administrative expenses of the
5 bankruptcy estate.

6 JUSTICE SOTOMAYOR: This -- this is hard for
7 me to understand, given the last line. "The estate
8 shall be liable for any tax imposed on such corporation
9 or partnership, but not for any tax imposed on partners
10 or members."

11 By the logic of that last sentence, it seems
12 to me that the preceding section is not looking to the
13 estate, but to the debtor, to pay the taxes.

14 MS. FREEMAN: The debtor pays the taxes, but
15 with estate assets because those are the only assets
16 that exist.

17 JUSTICE SOTOMAYOR: So, why -- why would the
18 last sentence be necessary?

19 MS. FREEMAN: The last sentence, I believe,
20 Your Honor, deals with a partnership, and in a
21 partnership case, just as outside the bankruptcy, the
22 partnership files the tax return and the partners
23 individually are the ones who pay the taxes. But they
24 pay the taxes. If a partner is in its own bankruptcy
25 estate with the only assets that exist -- all of his

1 income, all of his wages, all of those are property of
2 the bankruptcy estate, and he would use it to pay the
3 taxes. He's not individually liable any more than if a
4 trustee were individually liable. The trustee in a
5 bankruptcy case uses estate assets to pay taxes. And
6 so, what --

7 JUSTICE KENNEDY: But it says the estate --
8 the estate's not liable for the tax imposed on the
9 partners. So, if it's not liable, how can it ask for a
10 discharge?

11 MS. FREEMAN: The -- the debtor ultimately
12 is the one who receives a discharge. Discharge
13 provisions are separate than the -- than the tax payment
14 issues. Tax payment deals with what moneys are used to
15 make the payments of taxes during the course of
16 administration of a bankruptcy case. The debtor
17 receives a discharge in a chapter 12 case if it
18 complies -- if he complies with all of the provisions of
19 his plan of reorganization and then receives a
20 discharge.

21 There are exceptions to the discharge.
22 Certain prepetition taxes are excepted from a discharge
23 and would carry through during the -- postpetition. But
24 the farm sale statute provides that these particular
25 administrative expenses would be subject to a discharge

1 if he complies with the rest of the provisions of the --
2 of his plan of reorganization.

3 JUSTICE BREYER: What happens in a 12 or 13
4 case, just your typical case -- and this must arise
5 fairly often -- in year 1, on January 1, the farm or the
6 ship or whatever is the subject goes into chapter 12 or
7 13. They have a lot of pre-1 debt. Then in year 2 and
8 year 3, the proceedings are going on, but the farm is
9 operating, so is the ship, or whatever. And they
10 earn -- they run up debts during that time. People give
11 them fertilizer -- they -- you know, all kinds of
12 things. So, they have a lot of debts that they've run
13 up in that time. Now it draws to a close, at the end of
14 year 3.

15 Now, what about those debts that have been
16 run up during that time? There isn't a separate
17 bankruptcy estate for tax purposes, I understand. But
18 if Joe Smith has loaned his farm some money during that
19 time, and it comes time to look at the future income to
20 subtract the prepetition debts, does his debt get wound
21 up and get some priority in that process, or is he just
22 at the end of the queue?

23 MS. FREEMAN: He does get priority in that
24 process, Your Honor.

25 JUSTICE BREYER: All right. Well, if he

1 gets priority, then why in heaven's name shouldn't a tax
2 get priority?

3 MS. FREEMAN: Your Honor --

4 JUSTICE BREYER: That's your point.

5 MS. FREEMAN: -- it does have that priority.

6 JUSTICE BREYER: And if it does, then, of
7 course, the exception that Senator Grassley put in
8 applies to that. So, that's a question I should ask
9 them, given your answer.

10 MS. FREEMAN: Yes, Your Honor.

11 And, in fact, those taxes, along with the
12 light bill and any other administrative expenses, would
13 be paid when due over that 2- or 3-year period. And
14 that's certainly what happens in the large chapter 11
15 bankruptcy case, like a Delphi bankruptcy case or, you
16 know, a General Motors, for instance.

17 CHIEF JUSTICE ROBERTS: Well, but I mean,
18 your -- it is a question for you, because these things
19 don't go for 2 or 3 years, do they? I thought typically
20 they are wrapped up very quickly, and that's to the
21 advantage of the debtor. And your position with respect
22 to postpetition taxes has the potential of extending
23 them beyond the kind of quick turnaround that helps
24 everybody.

25 MS. FREEMAN: Respectfully, Mr. Chief

1 Justice, in chapter 12 cases, often the bankruptcy
2 estate will drag on for 2 or 3 years, and certainly for
3 longer than 1 year and much longer than a chapter 13
4 case, because you do have sales of assets. You have
5 debts that need to be restructured. You have leases
6 that end up getting rejected. You have a -- new crop
7 subsidies that are applied for and received. The
8 chapter -- the -- the amicus curiae brief of the
9 professors has a study, and shows how long chapter
10 12 cases generally last.

11 CHIEF JUSTICE ROBERTS: How long was this --
12 this one?

13 MS. FREEMAN: This case, Your Honor, because
14 of this appeal, has lasted from 2005 through today. So,
15 a considerable period of time. And all of the taxes
16 during that period of time and all of the operating
17 expenses during that period of time are administrative
18 expenses and are payable in the ordinary course.
19 There's an administrative expense claim if in fact they
20 haven't been paid.

21 And if -- if one of the creditors has not
22 received payment or if a taxing authority has not
23 received payment, it can move for payment as an
24 administrative priority. It can ask that it be paid
25 now, and it can ask that the case be dismissed if it

1 hasn't been paid. So, you do have that highest
2 priority, and this is consistent with the Court's
3 Nicholas case, 1966, which preceded the Bankruptcy Code
4 and which the Bankruptcy Code really incorporated and
5 continued with.

6 In the Nicholas case, the Court said that
7 all taxes incurred by a debtor-in-possession and
8 incurred during the administration period have
9 administrative expense priority, and they are payable by
10 the debtor-in-possession as an officer of the court, as
11 -- as the administrator of the estate under 28 U.S.C.
12 section 960, which is still in effect today, and which
13 requires that the person in control of the bankruptcy
14 estate, whether it's a trustee or a
15 debtor-in-possession, pay those taxes, but not pay them
16 with his own money.

17 As the Court said in the Nicholas case, you
18 pay them with the assets of the estate. The individual
19 trustee is not responsible; the individual
20 debtor-in-possession is not responsible. The
21 responsibility of the debtor-in-possession really is a
22 matter of the discharge provisions, whether he's going
23 to be separately discharged or if he has responsible
24 person liability because he's -- he's -- you're dealing
25 with trust fund taxes, with wages from some other

1 person --

2 JUSTICE BREYER: The -- what you say to me
3 makes a great deal of sense, but I think one of their
4 stronger arguments is, it may make sense. But,
5 unfortunately, even if Senator Grassley and the others
6 wanted it, they didn't do it right technically. They
7 didn't amend the right provision of the code, and
8 whoever's fault that is, is beside the point. So,
9 there's no way to get the words to get to the result
10 that you want.

11 I'll tell you the best I could do, and I see
12 a problem with it. If you say that -- you go to
13 1226(b)(1), and it says that any unpaid claim of the
14 kind specified in 507(a)(2); and 507(a)(2) talks about
15 administrative expenses and refers you to 503; and 503
16 includes taxes and administrative expenses; and then you
17 say it's -- at 1220 whatever it is, what did I just say?

18 MS. FREEMAN: 1226?

19 JUSTICE BREYER: 1226.

20 MS. FREEMAN: Uh-huh.

21 JUSTICE BREYER: It's like an Abbott and
22 Costello movie.

23 (Laughter.)

24 JUSTICE BREYER: The -- the -- you get to
25 1226(b)(1), and it says that that's -- shall be paid any

1 unpaid payments of that kind, including administrative
2 expenses. And -- and so, then you have 1222(a), which
3 refers to that, and then the amendment applies to that.

4 But what I did was I sloughed over by
5 talking too quickly -- it talked about "claim" -- of a
6 "claim," it says, any unpaid claim of the kind specified
7 in 507(a)(2). And when you look to 507(a)(2), it talks
8 about claims and expenses; and then in (2) there, it
9 refers to administrative expenses. And so, I think the
10 Government says they left out what was key to you, the
11 word "expenses."

12 All right? Now, I don't know what I'm doing
13 when I start tinkering with this Bankruptcy Code. And
14 is that just true, what they say? It does leave out the
15 word "expenses." Will -- will we cause untold harm if
16 we were to read the word "claims" there to include
17 expenses?

18 MS. FREEMAN: Your Honor, respectfully, you
19 would cause untold harm because this provision applies
20 in corporate chapter 11's and in all bankruptcy cases.
21 They all have the administrative expense provision, 503,
22 and they all have section 507. So, you would stop taxes
23 from being payable in a big Delphi --

24 JUSTICE BREYER: No, but I was thinking, so
25 if I do it by reading the word "claims" --

1 MS. FREEMAN: Right.

2 JUSTICE BREYER: -- in 5 -- in 1226, when it
3 says "any unpaid claim" --

4 MS. FREEMAN: Right.

5 JUSTICE BREYER: Which is what you want to
6 have include taxes --

7 MS. FREEMAN: And claim --

8 JUSTICE BREYER: -- to read that word as
9 including both the 507(a) claims, which are in (1)(a),
10 (1)(b), and -- and also administrative expenses in (2).
11 Can I do that?

12 MS. FREEMAN: You can, Your Honor, because
13 "claim" is defined in section 101 of the code as right
14 to payment. "Creditor" is defined as someone who has a
15 claim that arose prepetition, which necessarily means
16 "claim" is broader and not just one that arose
17 prepetition.

18 There are numerous provisions of the
19 Bankruptcy Code that refer to administrative expenses as
20 claims, including 1226. And so, the Court can see that
21 those are interpreted consistently.

22 This Court, in the Hartford Underwriters
23 case, referred to administrative claims, calling them
24 claims as well as administrative. And really what the
25 Government's argument here is that administrative

1 expenses are outside of bankruptcy altogether, that
2 they're not part of what get paid in a bankruptcy case.
3 And that's simply untrue.

4 If the Court looks at the provisions with
5 respect to requirements of a plan, including 1222(a),
6 which apart from the exception, it says that
7 administrative expenses are required to be paid.
8 Section 1228 says that a plan discharges all debts
9 including debts provided for -- allowed under section
10 503. Debt is a liability on a claim.

11 JUSTICE BREYER: But that doesn't answer my
12 first question, what actually happens? I mean, this
13 isn't the first year of chapter 12 and 13.

14 MS. FREEMAN: Right.

15 JUSTICE BREYER: And there must be instances
16 where the -- where the debts run up postpetition are
17 pretty big --

18 MS. FREEMAN: And --

19 JUSTICE BREYER: -- and there isn't enough
20 money to go around, and they're going to have to be paid
21 out of future income along with the prepetition debts.
22 And it can be done, but there is a question of
23 priorities, and the Government is saying there is no
24 priority -- I think they're saying that -- for a
25 postpetition debt. And -- and you're saying, oh, but of

1 course there is.

2 So, what actually happens? There have been
3 perhaps thousands and thousands of cases, haven't there?

4 MS. FREEMAN: And administrative expenses do
5 get paid in the ordinary course. And if the taxes
6 aren't paid --

7 JUSTICE BREYER: Get paid, if necessary, by
8 assigning priorities?

9 MS. FREEMAN: Yes. They have administrative
10 priority, and they do get paid.

11 JUSTICE BREYER: And so, to look to a
12 hornbook on bankruptcy law which just tells me what
13 you've just said, I would look where?

14 MS. FREEMAN: We -- we've cited a number of
15 hornbooks that have exactly that provision. What's
16 particular interesting with respect to the Government's
17 position here is that, at the Government's urging,
18 section 507(a)(8) of the Bankruptcy Code, that provided
19 for prepetition priority, eighth priority, for
20 prepetition taxes within a short period before the
21 Bankruptcy Code, was amended; so that all of those
22 eighth priority taxes during the year of the filing, the
23 straddle year -- here the Halls filed their bankruptcy
24 case in August; so, during the entire period from
25 January 1 through August when they filed -- are treated

1 as administrative expenses. And yet, now they say
2 administrative expenses mean nothing, and they don't get
3 any payment as administrative expenses.

4 Why urge the change? Why make all of those
5 year-of-filing taxes into administrative expenses and
6 then say the administrative expenses have no meaning?

7 JUSTICE SOTOMAYOR: I'm going to ask the
8 Government this, but are you aware of any circuit split
9 or any cases below that have accepted the Government's
10 arguments that chapter 12 involves prepetition debts
11 only and that don't pay administrative expenses
12 postbankruptcy?

13 MS. FREEMAN: There are several cases that
14 have interpreted section 1222(a)(2)(A). None of them
15 have addressed the change in 507 or what that means.

16 JUSTICE SOTOMAYOR: That's a different
17 question.

18 MS. FREEMAN: Okay.

19 JUSTICE SOTOMAYOR: The Government's now
20 saying that chapter 12 involves only prepetition claims.

21 MS. FREEMAN: Right.

22 JUSTICE SOTOMAYOR: And it's basically, by
23 that argument, saying it doesn't involve and can't
24 involve administrative expenses. That's how I read
25 their argument.

1 MS. FREEMAN: I think that's --

2 JUSTICE SOTOMAYOR: And so, I'm asking is --
3 are there any courts that you're aware of below who have
4 been presented with this argument, outside of the tax
5 situation, who have accepted it?

6 MS. FREEMAN: I --

7 JUSTICE SOTOMAYOR: Who have failed to give
8 priority to administrative expenses?

9 MS. FREEMAN: None outside of this tax
10 situation. And, Your Honor, I don't believe that any of
11 the cases that have followed the Government's
12 interpretation of this farm sale statute, 1222(a)(2)(A),
13 have addressed the impact on other administrative
14 expenses and other tax claims. The wages -- the taxes
15 on wages that are incurred, the lottery winnings that an
16 individual farmer might have, and the fact that those
17 have administrative priority and that those would need
18 to be paid off the top as administrative expenses --
19 none of the cases address those.

20 JUSTICE SOTOMAYOR: I'm not asking you to
21 defend their position.

22 MS. FREEMAN: Okay.

23 JUSTICE SOTOMAYOR: It's just such a broad
24 position that I'm trying to understand if there's a
25 split out there that we are unaware of.

1 MS. FREEMAN: And the problem, Your Honor,
2 is that it does have these broad impacts, and none of
3 the courts have really addressed it. And I don't
4 believe that certainly the --

5 JUSTICE SOTOMAYOR: So, can we go back to
6 the issue that gives me trouble?

7 MS. FREEMAN: Yes, Your Honor.

8 JUSTICE SOTOMAYOR: How to read "incurred by
9 the estate." If the estate doesn't pay taxes --

10 MS. FREEMAN: To incur --

11 JUSTICE SOTOMAYOR: -- how could it be
12 incurred by the estate when Congress, if it intended
13 what you're saying it intended, could have said
14 "incurred during bankruptcy"?

15 MS. FREEMAN: Incurred -- to incur is to
16 take on liability. So, at the point in time that income
17 is generated during a bankruptcy case, then liabilities
18 are taken on at the same time, the operating expenses,
19 the taxes. Here, you had a clear estate asset, the Hall
20 farm. It was sold. That generates an income tax
21 liability, a capital gains liability. And so, that
22 is -- it's tied to the income, which is here property of
23 the estate. The -- the important thing is --

24 JUSTICE SCALIA: But -- but the problem is
25 that, with an exception that -- that's not applicable

1 here, section 1399 of the Internal Revenue Code provides
2 that no separate taxable entity shall result from the
3 commencement of a case under Title XI of the United
4 States Code.

5 How can you incur a tax when you are not a
6 separate taxable entity?

7 MS. FREEMAN: Your Honor, because you are a
8 single taxable entity instead of a separate taxable
9 entity. The whole reason for the separate taxable
10 entity section was when you had a bankruptcy estate that
11 consisted only of the assets on the petition filing
12 date, and the debtor earns income independently. So,
13 the debtor would independently have tax liability, and
14 that would be separate from the estate.

15 But when you have a reorganization case, a
16 corporate chapter 11 or a chapter 12, then the estate
17 and the debtor are a single taxable entity, and the
18 debtor is the one that files the tax returns or the
19 debtor-in-possession, the trustee, if there's a trustee
20 in control --

21 JUSTICE SCALIA: Well, if -- if that
22 exception were intended, the provision I read contains
23 an exception. It says "except in any case to which
24 section 1398 applies." 1398 applies to chapter 7 and
25 chapter 11 where the debtor is an individual.

1 MS. FREEMAN: That's --

2 JUSTICE SCALIA: Now, if there is an
3 additional exception for chapter 12 of the sort that you
4 allege, why wasn't that put in there?

5 MS. FREEMAN: There is no exception, and
6 there shouldn't be an exception, Your Honor. They're
7 within section 1399, just like corporate chapter 11
8 debtors. The debtor is the one that files the tax
9 return. The debtor and estate are one. All of that
10 corporate earnings, all of the wages, the lottery
11 winnings, the farm sale proceeds, all of those are part
12 of the estate. And so, the --

13 JUSTICE SCALIA: What does it mean, then, to
14 say that no taxable -- "no separate taxable entity shall
15 result"? What does it mean, unless it means that it is
16 not the estate which incurs the tax?

17 MS. FREEMAN: Your Honor, respectfully,
18 there's a difference between taxable entity and estate.
19 The estate is a collection of property. That is the
20 collection of property that's operated by the
21 debtor-in-possession or trustee in a reorganization
22 case.

23 JUSTICE SCALIA: Well, but they -- but they
24 would not have needed the exceptions for chapter 7 and
25 chapter 11 where the debtor is an individual if what you

1 say is true, if indeed a bankrupt estate is, as you say,
2 not an entity at all.

3 MS. FREEMAN: You need that exception, Your
4 Honor, in a chapter 7 case for an individual because the
5 individual earns income that is wholly independent from
6 the estate, that's not part of the estate. So that the
7 bankruptcy estate consists of the assets the individual
8 owns on the petition filing date. The trustee
9 administers those, sells the assets, may incur some
10 liability for selling the assets for taxes, pays those,
11 and deals with those, while the individual continues to
12 earn income postpetition that's his own income. And so,
13 you need to have a separate taxable estate in those
14 instances.

15 But when the income that's earned during
16 this whole period of administration, from the petition
17 filing date to the confirmation date of the plan, is all
18 property of the estate, then the debtor, the corporate
19 chapter 11 debtor or the -- the corporate chapter 12
20 debtor or the individual chapter 12 debtor is incurring
21 that income as part of the estate. It's all property of
22 the estate in a chapter 12 case. Section 1207 says
23 that.

24 And so, the debtor is the one that files the
25 tax returns, and the debtor uses the estate assets to

1 make the payments of the taxes and to make the payments
2 on the light bill and to make the payments on all of the
3 other expenses of administration during this period of
4 administration. That's what this Court held in
5 Nicholas, and that continues on in effect today.

6 JUSTICE KAGAN: But, Ms. Freeman, wouldn't
7 it be fair to say then that the taxes are incurred by
8 the debtor and payable out of the estate? Why would it
9 say "incurred by the estate"?

10 MS. FREEMAN: It uses the term "incurred by
11 the estate" I think based upon the same kind of language
12 that this Court used in Nicholas, as incurred by the --
13 incurred during the administration period, incurred by
14 the debtor-in-possession. It's -- it's really a broad
15 sense of all of the kinds of bankruptcy estates in a
16 chapter 7 case. It -- this refers to all bankruptcy
17 cases.

18 And so, in a chapter 7 case, it's going to
19 be just the assets that exist there on the petition
20 filing date. If it's a corporate case, it's going to be
21 the -- all of the assets that are generating the income
22 during the course of the administration of the chapter
23 12 or the chapter 11 case or even the chapter 13 case.

24 In chapter 13 cases, you have a specific
25 additional provision, section 1305, that deals with

1 taxes payable postpetition, and it also includes
2 postconfirmation. So, it gives the government a broader
3 kind of right so that --

4 JUSTICE GINSBURG: The argument is made
5 against your position that 1305 is one of the provisions
6 that was featured, I think, both in the Ninth Circuit
7 and the Tenth Circuit, and their position seems to be
8 that 1305 gives the government an election.

9 MS. FREEMAN: It does, Your Honor, provide
10 for an election for the government. What's important is
11 that in a 13 case, unlike a 12 or an 11, you have a very
12 short period of administration. They have to file their
13 plan within 15 days. It's confirmed within a month or
14 two. And it's very unlikely that April 15th is going to
15 fall within that short period of time, and that's when
16 the Government says that your taxes are incurred. So,
17 you're going to have a -- it's unlikely you're going to
18 have an administrative expense claim for your income
19 taxes during the period of administration of a chapter
20 13. It's a very short period.

21 So, the government has the option not only
22 during the administration period, but also during the
23 whole period of the plan, to elect to say: All right,
24 there have been some big commissions earned here, and I
25 want to go ahead and collect from the estate rather than

1 just wait and see what the debtor earns afterwards. And
2 so, it then can go ahead and file a claim and ask to
3 have that claim paid out of the bankruptcy estate, and
4 it really gives the government much broader rights than
5 it does in a normal chapter 11 or a chapter 12 case or a
6 7.

7 If I may reserve the remainder of my time
8 for rebuttal.

9 CHIEF JUSTICE ROBERTS: Thank you,
10 Ms. Freeman.

11 MS. FREEMAN: Thank you.

12 CHIEF JUSTICE ROBERTS: Mr. Shah.

13 ORAL ARGUMENT OF PRATIK A. SHAH

14 ON BEHALF OF THE RESPONDENT

15 MR. SHAH: Mr. Chief Justice, and may it
16 please the Court:

17 The postpetition income tax liability at
18 issue in this case is not subject to section 1222(a)(2)
19 and thus cannot be treated as a dischargeable
20 nonpriority debt for two reasons. First, consistent
21 with the structure of chapter 12, a chapter 12 plan is
22 limited to prepetition debts and does not cover
23 postpetition debts, including administrative expenses.
24 Rather, postpetition administrative expenses are paid
25 separately through section 1226(b)(1), which contains no

1 farm sale exception. Because section 1222(a)(2)(A)
2 strips priority only from a subset of claims covered by
3 a chapter 12 plan and does not alter which debts fall
4 within that plan, it cannot apply to the postpetition
5 tax liability at issue.

6 JUSTICE GINSBURG: So, what -- what farm
7 sales would be included? What farm sales would get this
8 benefit that Senator Grassley obviously wanted them to
9 have?

10 MR. SHAH: Your Honor, it would be
11 prepetition sales. That is, any capital gains tax
12 incurred from a prepetition sale, those would be
13 priority expenses covered under a chapter 12 plan under
14 section 1222(a)(2), because they fall under -- they're
15 an -- they're a priority claim under section 507(a).

16 CHIEF JUSTICE ROBERTS: Does that -- does
17 that make sense, though, in terms of if you're talking
18 about farmers and fishermen and you're talking about the
19 treatment of their central asset, whether it's the farm
20 or typically the boat, and they either want to try --
21 they want to try to save the farm or the boat, and they
22 go into bankruptcy, and the big issue is how that
23 asset's going to be treated. And your position is it's
24 not in the bankruptcy at all; it's outside of it. That
25 seems to me to be at least counterintuitive.

1 MR. SHAH: Well, Your Honor, two points:
2 One, as a practical matter, chapter 12 is a
3 reorganization provision. It's not a provision just
4 designed to allow farmers to get out of the business of
5 farming. So, often what will happen is that farmers
6 will try to reorganize some of their farm sale assets,
7 sell some of their livestock, change their farming
8 operation, to see if they can save it outside of
9 bankruptcy first.

10 All of those sales -- an example of that is
11 the Knudsen case. Knudsen is the only circuit case to
12 go Petitioners' way. In Knudsen, it not only involved
13 the postpetition tax liability of the type at issue in
14 this case; it also had a significant prepetition tax
15 liability component in that case based upon just what I
16 was explaining, the farmer trying to -- trying to change
17 their farming operation to save the farm without having
18 to go into bankruptcy.

19 CHIEF JUSTICE ROBERTS: Yes, but also, I
20 gather, it's a fairly typical situation where you have
21 farmers that might want to sell part of the farm. You
22 know, they have dairy and corn operations or something,
23 and they sell one to try to preserve the other. And
24 that's -- that's exactly the sort of thing that should
25 be considered in the bankruptcy context. And yet, your

1 position says we're going to treat it outside the
2 bankruptcy.

3 MR. SHAH: Well, Your Honor, it certainly
4 happens within the bankruptcy, and I'm not disputing
5 your point that that may -- that may arise in a
6 bankruptcy case just like it arises in this case. And
7 it will be dealt through the bankruptcy. That is, the
8 sale will happen, and it will be approved by the
9 bankruptcy court. The question is, how do you treat the
10 capital gains tax arising --

11 CHIEF JUSTICE ROBERTS: But that's a big
12 deal if you're deciding how the plan's going to work,
13 whether they -- I mean, what the amount was here was big
14 for the farmer, and the idea of, well, we're going to
15 pretend that's not at issue here seems to me to be --
16 again, not -- not to make a lot of sense.

17 MR. SHAH: Your Honor, we're not asking, to
18 be clear, to pretend that that's not there. How the tax
19 liability would be dealt with under the Government's
20 view is at the time the debtor moves to sell the farm
21 asset during the bankruptcy case -- like in this case,
22 that sale of the farm asset generated \$960,000. That
23 was the sale price. The capital gains tax liability in
24 this case is \$29,000. If they would have set aside from
25 that \$960,000 sale price \$29,000 to pay the capital

1 gains tax debt, that would resolve the issue. We're not
2 saying that you ignore it.

3 JUSTICE KAGAN: But there's every reason to
4 think, Mr. Shah, that what Congress was worried about
5 here was cases in which the bankruptcy plan would not be
6 approved at all because there were very high capital
7 gains taxes that would result from a sale and that that
8 was the problem that everybody was focused on, was
9 making sure that farmers could take advantage of section
10 12. So, it's a little bit odd -- it's actually more
11 than a little bit odd. It's a lot odd to read the
12 statute to apply not in that context but only as to
13 people who have somehow managed to sell their property,
14 you know, 18 months before going into bankruptcy.

15 MR. SHAH: Sure. So, Your Honor, when you
16 say that everybody was focused on this problem, we have
17 the evidence of exactly one person as to what one
18 legislator thought that this bill would do. That's
19 Senator Grassley. Now, admittedly, Senator Grassley's
20 statements do indicate an intent on his part to reach
21 postpetition taxes. But the pre-existing statutory
22 framework does not permit that result.

23 What section 1222(a)(2)(A) does is it allows
24 the debtor to strip priority from a certain subset of
25 governmental claims, such as prepetition taxes, and

1 there is no doubt that Senator Grassley correctly
2 understood that's how section 1222(a)(2) --

3 JUSTICE ALITO: But it's not just Senator
4 Grassley. Your interpretation makes this provision,
5 1222(a)(2)(A), of very, very little practical value.
6 And you think that's what Congress intended? Not only
7 would it -- would it mean that postpetition capital
8 gains on the sale of part of the farm or the entire farm
9 would -- would be outside of the bankruptcy, outside of
10 the bankruptcy, but all of the prepetition capital gains
11 would be outside of it too, unless they occurred in a
12 previous taxable year.

13 MR. SHAH: A couple of responses, Your
14 Honor. First of all, I don't think it's sort of a null
15 set or a vanishingly small set. There's the Knudsen
16 case which qualifies. Of -- in the professors' amicus
17 brief, on page 10a of their amicus brief, they provide a
18 chart of representative cases involving postpetition tax
19 liabilities. They cite eight cases in their chart on
20 page 10a. Three of those eight cases involve
21 significant prepetition tax liabilities, even under the
22 narrower definition of "prepetition."

23 But -- but to get to your larger point, even
24 to the extent it might be narrower than what Congress
25 intended, Congress certainly knew how section 1222

1 operated in the sense that it would strip priority from
2 certain claims that are already entitled to priority
3 under a chapter 12 plan, such as prepetition taxes. And
4 both sides agree that that's how section 1220(a)(2)(A)
5 works. There's no dispute about that.

6 The dispute is about whether this
7 postpetition tax liability comes within the chapter 12
8 plan in the first place. That dispute turns on
9 pre-existing code provisions, part of the 1978 Act, part
10 of the 1980 Act, and the 1986 Act. Whatever deference
11 Senator Grassley is owed as to the operation of section
12 1220(a)(2)(A) itself, he's owed no deference whatsoever
13 as to the proper interpretation of those pre-existing
14 code provisions.

15 It's our position that these pre-existing
16 code provisions, section 503(b), section 346, and
17 section 1398, 1399, all lead to the result that
18 postpetition tax liabilities are not an administrative
19 expense within the meaning of the code.

20 JUSTICE GINSBURG: How about employment tax?
21 Employment taxes?

22 MR. SHAH: Your Honor, employment taxes
23 arguably could be treated differently. Now, as a matter
24 of discretion, IRS has chosen not to treat them
25 differently. That is, they don't try to seek those as

1 administrative expenses. I think there would be an
2 argument -- and we set this -- set forth the argument in
3 a footnote of our brief. What the potential argument
4 would be is that they could be deemed an administrative
5 expense not because they're incurred by the estate, but
6 under the other part of the definition of an
7 administrative expense under 503(b)(1)(A).

8 JUSTICE BREYER: Just following up on
9 that --

10 MR. SHAH: Yes.

11 JUSTICE BREYER: -- I'm looking for what I'd
12 call past practice, where there must be a lot --

13 MR. SHAH: Yes.

14 JUSTICE BREYER: -- that would shed some
15 light on this. So, I see -- your point that we cannot
16 call these taxes administrative expenses is because when
17 that's defined in 503 for the entire code --

18 MR. SHAH: Yes.

19 JUSTICE BREYER: -- it talks about
20 administrative expenses incurred by the estate.

21 MR. SHAH: Yes, Your Honor.

22 JUSTICE BREYER: And so, you're saying here
23 are three people who incurred their own taxes. One is
24 section -- section 12; one is section 13; and one is
25 individuals in section 11. Is that right?

1 MR. SHAH: Ah --

2 JUSTICE BREYER: At least that's my --

3 MR. SHAH: Yes. Yes, Your Honor.

4 JUSTICE BREYER: Yes. Okay. So, we have
5 three categories of people that -- where the taxes,
6 literally taken, they incur postpetition taxes. Now,
7 the bite would come up if it turned out, when they were
8 getting around to settle these things, that there isn't
9 enough money to pay fully the postpetition or let's --
10 no, to pay fully domestic support obligations, wages,
11 and also Federal taxes.

12 Isn't that -- that's where it's going to
13 show up, because the question will be, do you have to
14 shave the Federal taxes because they're coming in to be
15 paid as an administrative expense priority which is
16 only there as number 2, I think, in light of number 1.
17 Or do you not shave them at all? If they're liable
18 personally, there isn't any reduction in the amount of
19 the Federal Government -- if they're allowed because
20 it's one of the estate's expenses basically, using the
21 estate very, very loosely, then they would have to take
22 a reduction, too. Am I right? Are you following it?

23 MR. SHAH: I think so. Let me try to say
24 what I think what you're saying. Under chapter 12 and
25 13, if it is in fact a priority claim, whether it's a

1 priority claim or an administrative expense, those have
2 to be paid in full. There isn't an ability for the
3 court to shave those --

4 JUSTICE BREYER: No. The administrative
5 expenses don't have to be paid in full if there isn't
6 enough money for them too in unsecured claims for
7 domestic support obligations, because administrative
8 expenses is the second priority; it isn't the first.

9 MR. SHAH: Okay. So, Your Honor, there is a
10 misunderstanding I think in what you are saying. That
11 is, in a chapter 12 plan, the priorities matter more in
12 terms of the relative priority between category 1, 2, 3,
13 4, 5, 6, 7, and 8. They matter more in a chapter 7
14 liquidation where there's a finite set of assets being
15 liquidated, and then those will be paid out in the
16 priority that you're talking about. In a chapter 12 or
17 13 case, there's going to be a plan proposed, and that
18 plan will be confirmed.

19 Now, under 1222(a)(2), any of those priority
20 claims, whether it's first priority or eighth priority,
21 has to be set out and to be paid in full in order for
22 the plan to be confirmed.

23 JUSTICE BREYER: Okay.

24 MR. SHAH: So, the plan won't be confirmed
25 at all. There isn't a matter of ordering the priorities

1 in a chapter 12 or 13 case.

2 Now, if I could turn back to Justice
3 Sotomayor's question.

4 JUSTICE SOTOMAYOR: Could you turn back
5 to -- before you answer my other question, could you
6 finish your thought on what you're doing with wages?
7 Are they given priority or aren't they? If you're
8 saying they're not -- if we accept your reading of this,
9 employee wage taxes are not administrative expenses.

10 MR. SHAH: Right. Or -- well, Your Honor,
11 they're certainly not administrative expenses under the
12 definition of incurred by the estate. That would be the
13 relevant issue in this case. They may come under the
14 other definition of administrative expense; that is, the
15 costs -- necessary costs of preserving the estate, like
16 wages. If you consider the employment payroll tax
17 that's paid simultaneously as the wage, as part and
18 parcel of the wages, you could get at it that way. But,
19 again, that doesn't have anything to do with the
20 "incurred by the estate" language.

21 The "incurred by the estate" language, as
22 you properly point out, is relevant -- the most relevant
23 provisions as to whether a tax is incurred by the estate
24 are sections 346(b) and 1398 and 1399 --

25 JUSTICE KAGAN: How does that work,

1 Mr. Shah? Because this was a part of your argument that
2 I have to say sort of tripped me up --

3 MR. SHAH: Okay.

4 JUSTICE KAGAN: -- because you define
5 "incurred by the estate" by reference to those
6 provisions, but those provisions were enacted 2 years
7 and 4 years after the phrase that you are trying to
8 define.

9 MR. SHAH: Sure.

10 JUSTICE KAGAN: So, it must have been a very
11 prescient Congress.

12 MR. SHAH: Well, Your Honor it was a
13 prescient Congress, because in the legislative history
14 that we cite, they say -- and it's not true that all of
15 the -- separate taxable entity rules weren't implemented
16 until afterwards. There -- section 346, which dealt
17 admittedly only with State and local taxes, they set up
18 rules, the same separate taxable entity rules that
19 Congress later enacted 2 years later, to apply to State
20 and local entities. And that's the provision 346 that's
21 reprinted in our appendix at page 2.

22 What Congress said when they passed 346 is
23 "we fully" -- "we fully expect" -- and as they had
24 originally drafted them in the 1978 Act, to also apply
25 to Federal taxes. But it decided to pull them out of

1 the Act so as not to step on the shoes of the
2 jurisdiction of the Ways and Means Committee. That's
3 the explanation that Congress provided and then 2
4 years --

5 JUSTICE KAGAN: But you're saying that as of
6 1978, there was kind of an idea in people's heads about
7 this separate tax entity or at least in some people's
8 heads, but that idea had never been converted into any
9 statutory language. And you're suggesting that we
10 should take this phrase "incurred by the estate" and
11 read it as if they were referring to something real that
12 was in a statute.

13 MR. SHAH: It's not simply taking out of
14 their head, Your Honor; it's -- the section 346 rules
15 which are parallel and apply to State and local taxes,
16 those didn't come out of nowhere. Those came out of
17 prior IRS rulings as to when there is a separate taxable
18 entity in a bankruptcy case.

19 There were pre-existing -- before the 1978
20 Act, in particular, there was a 1972 IRS revenue ruling
21 which set forth the rules about when there's a separate
22 taxable entity, whether the Act should -- whether the
23 tax should be taxed to the estate or to the debtor.
24 Section 346 in the 1978 Act codified those rules for
25 State and local income taxes.

1 In the intervening 2 years between 1978 and
2 1980 when Congress consummated the step and extended
3 those to Federal taxes, the IRS was still applying its
4 pre-existing practice based on its revenue ruling. So,
5 there wasn't a gap where there was no guidance as to
6 whether -- how to determine whether these were incurred
7 by the estate or not.

8 Courts may -- courts readily would have
9 looked, I presume, to the 1972 Treasury ruling and the
10 parallel 346 rulings in that gap time until the
11 legislative guidance came along and then codified that
12 result with respect to Federal taxes.

13 Now, I think to --

14 JUSTICE KAGAN: Can I ask another
15 question --

16 MR. SHAH: Sure.

17 JUSTICE KAGAN: -- while we are on this?
18 Because the 1398, 1399 would suggest that we're looking
19 to this separate taxable entity, but if I understand
20 correctly, in the corporate context, the IRS actually
21 does not look to that. It looks to just the question of
22 who's filing the tax return.

23 So, if that's the case, aren't you, in that
24 very large bankruptcy context, losing your textual
25 anchor entirely?

1 MR. SHAH: No, Your Honor. There are two
2 ways that a bankruptcy estate can incur a tax. One is
3 if it's a separate taxable entity, then it -- then it's
4 responsible for the taxes. All the taxes are taxed to
5 the estate, and it has to file the return and pay it.

6 The other way is if it has the duty to file
7 the return. That's a different provision of the
8 Internal Revenue Code, section 6012(b)(3). 6012(b)(3)
9 also appears in the Government's -- in the appendix to
10 the Government's brief. What 6012(b)(3) on page 14a
11 says is that, in a bankruptcy case, the trustee of a
12 corporate bankruptcy estate shall make the return for
13 income in a corporation.

14 What this Court held in Holywell, which both
15 sides cite and both sides agree, is that when a
16 corporate trustee has a duty to file a return under
17 6012(b)(3), it also has a duty to pay the tax. That is,
18 it incurs -- it's liable for or incurs the tax.

19 So, there are two ways to incur the tax:
20 One is separate taxable entity; the other way is if the
21 code imposes an obligation on the bankruptcy estate
22 to -- to file and pay the tax return. That's the other
23 way to interpret it, and that's why all the chapter 7
24 and 11 corporate cases that are cited by Petitioners are
25 inapt. In those cases, the postpetition tax liabilities

1 are, in fact, incurred by the estate.

2 What's remarkable is that Petitioners do not
3 cite a single chapter 12 case in which a postpetition
4 tax liability has been treated as an administrative
5 expense. Chapter 12 has been around since 1986, and
6 yet, there is not -- if this was such a big problem that
7 Congress was trying to get at it through this way, you
8 would have expected at least a single case in which a
9 postpetition tax liability had been treated as an
10 administrative expense.

11 JUSTICE BREYER: How would it show up? I
12 mean, what difference -- suppose -- suppose you -- in 11
13 individual, 12, or 13, what's the difference whether you
14 treated it as an administrative expense or not, as long
15 as they all have to be paid anyway, you say?

16 MR. SHAH: Sure. So, the difference is, in
17 chapter 12 and 13, they are treated outside of the
18 bankruptcy plan itself, but they do need to be paid up
19 front. And, in fact, they receive a special --

20 JUSTICE BREYER: No. I mean, how would we
21 know? How would we know --

22 MR. SHAH: Oh, that they're treated
23 differently?

24 JUSTICE BREYER: Yes.

25 MR. SHAH: Through the code. So, in chapter

1 12 and 13, 1226(b)(1) and 1326(b)(1), the parallel
2 provisions in chapter 13, they pull out administrative
3 expenses. They pull them out --

4 JUSTICE BREYER: No. Let's imagine you're
5 absolutely right. They mean to treat them differently.

6 MR. SHAH: Yes.

7 JUSTICE BREYER: They mean to treat the
8 postpetition tax obligation to the Federal Government
9 not as an administrative expense. But this is an
10 instance where the business will continue, and,
11 therefore, you have said in order to continue, you have
12 to pay all your tax liability and all your
13 administrative expenses.

14 MR. SHAH: Yes.

15 JUSTICE BREYER: Therefore, what difference
16 does it make whether you do or whether you don't treat
17 them as administrative expenses? What is the
18 operational difference?

19 MR. SHAH: Sure. Your Honor, it would be to
20 the government's advantage if these were in the ordinary
21 course -- at least before section 1222(a)(2)(A) was
22 enacted that stripped priority, it would have been in
23 the government's advantage to take the position that
24 these were administrative expenses. And the reason why
25 it's favorable to the government is, those have to be

1 paid up front as part of the bankruptcy.

2 If you don't treat them as administrative
3 expenses -- and the government took the self-denying
4 position here in the years leading up to 2005,
5 consistently taking the position these were not
6 administrative expenses, even though it was to the
7 government's disadvantage, because the code required
8 that interpretation. And the disadvantage is you don't
9 get -- the government didn't get them paid up front as
10 administrative expenses. They would have to collect
11 them outside of the bankruptcy. And when you go to
12 collect them outside of the bankruptcy, there's much
13 more uncertainty. There may not be any --

14 CHIEF JUSTICE ROBERTS: Well, it's certainly
15 not a self-denying position now, right? You're arguing
16 that these are -- that the taxes of this sort are
17 administrative expenses when that puts you at the head
18 of the line. You're arguing that they are not
19 administrative expenses, same type of taxes, when it
20 puts you at the back of the line, even though the
21 provision that puts you at the back of the line was
22 designed to particularly help the fishermen and -- and
23 farmers.

24 MR. SHAH: Your Honor, that -- that's just
25 not true. Dating back to 1998 -- and these are cited in

1 the Government's brief at pages 16a to 18a. Dating back
2 to 1998, the government had consistently taken the
3 position that postpetition tax liabilities --

4 CHIEF JUSTICE ROBERTS: No, I'm talking
5 about the position you're taking now. You argue for --

6 MR. SHAH: We have maintained our --

7 CHIEF JUSTICE ROBERTS: -- different
8 treatment of these taxes as to whether or not they're
9 administrative expenses -- not solely, but it leads to
10 the result that you get the money first either way.

11 MR. SHAH: Because Congress -- the
12 government has stayed consistent in its position.
13 Because Congress has changed the rules, it turns out
14 that that same interpretation --

15 CHIEF JUSTICE ROBERTS: Well, but then
16 you're saying that Congress changed the rules in a way
17 that, as Justice Alito's question suggested, really
18 doesn't do much at all, when what they wanted to do was
19 provide some real protection for farmers and fishermen.

20 MR. SHAH: I can't speak to what Congress
21 wanted to do. If in fact they wanted to do that, then
22 they did it the wrong way. They could have --

23 JUSTICE GINSBURG: What would be -- what
24 would be the right way?

25 MR. SHAH: You could easily enact a separate

1 provision within 1222 that said something like -- use
2 the language something like section 1305, that said any
3 taxes that become payable after of the filing of the
4 petition shall be treated as non-dischargeable,
5 nonpriority debts and paid that way.

6 But they didn't do that. And I think
7 section 1305 is critical here, and this goes to your
8 question, Mr. Chief Justice, as well, that the
9 government is trying to take advantage here. The --
10 adopting Petitioners' position would have a significant
11 ripple effect in chapter 13. This is not simply a
12 matter of trying to get to the result that Senator
13 Grassley intended by narrowly interpreting
14 1222(a)(2)(A), and it won't have any other effect in the
15 code. It will have a significant effect in the intended
16 operation of chapter 13.

17 And -- and the reason why that's important
18 is, is to put this in perspective, there are about 600
19 to 700 total chapter 12 filings each year. There's
20 somewhere in the upwards of 400,000 chapter 13 filings
21 each year, and here's where it would throw a wrench into
22 chapter 13. If you look at section 1305 of chapter
23 13 -- and that's reproduced on page 11a of the
24 Government's appendix. What 1305(a)(1) does is it
25 provides a special procedure for the government to file

1 a claim for postpetition taxes, exactly the type of tax
2 at issue in this case. It says: Government, you can go
3 file a claim to have that included within the bankruptcy
4 plan.

5 If -- if you adopt Petitioners' position,
6 there would never be a case in which the government
7 would ever have any occasion to invoke 1305(a)(1),
8 because they --

9 JUSTICE KAGAN: But why would that be a
10 problem? You said that there would be a significant
11 ripple effect and practical difficulties. And I
12 understand your argument about 13 shows that you have to
13 do this and why would 13 be necessary if Petitioner were
14 right, but you started out, I thought --

15 MR. SHAH: It -- yes.

16 JUSTICE KAGAN: -- by trying to show us that
17 it would be a significant practical problem --

18 MR. SHAH: I said it would be a significant
19 disruption to the intended operation of chapter 13. In
20 practice, it would actually mean that the government
21 comes out better under chapter 13 than in the
22 government's current position, because what Petitioners'
23 position would do, if you read --

24 JUSTICE KAGAN: So, it just does
25 automatically for the government what is now done by --

1 by some kind of government filing?

2 MR. SHAH: Well -- well, not even that, Your
3 Honor, because under -- the reason why 1305(a)(1) would
4 be dead letter -- you could just rip that page out of
5 the code and throw it away if you accept Petitioners'
6 reading. The reason why that's true is because under
7 their reading, it would get administrative expense
8 priority, which are paid up front, super-priority, even
9 before anything else; but under 1305(a)(1), it doesn't
10 get administrative expense priority; it may not even get
11 any priority at all.

12 And so, it's a significant change in the
13 operation of how the government would be seeking
14 postpetition tax liabilities. Now, it would work to the
15 detriment of the debtor in chapter 13 cases, the upwards
16 of 400,000 chapter 13 cases that would occur --

17 CHIEF JUSTICE ROBERTS: But those are --
18 those are small potatoes compared to the sale of a farm
19 and a boat, right?

20 MR. SHAH: I would -- I would --

21 CHIEF JUSTICE ROBERTS: Would there -- this
22 particular issue of large capital gains from a sale of
23 significant assets doesn't typically arise in the
24 chapter 13 cases.

25 MR. SHAH: Sure, the capital gains tax

1 wouldn't, but there's all sorts of postpetition income
2 taxes that would arise in a chapter 13 case. In a
3 chapter 13 case, those are wages that are being incurred
4 after the filing of the petition. All of the taxes on
5 those wages after the petition would be the -- the type
6 of -- would be eligible for postpetition tax treatment.

7 CHIEF JUSTICE ROBERTS: Well, in chapter --
8 chapter 13 cases are the ones that you -- that are
9 typically resolved very quickly, right?

10 MR. SHAH: Your Honor, it is true that --
11 from the statistics that I have seen, on average we're
12 talking about 4 months in a chapter 13 case. On average
13 in -- in a chapter 12 case, according to the professors'
14 amicus brief, median time is about 8 months.

15 What's clear from the legislative history,
16 the reason why Congress set up the chapter 13 rules as
17 to make the tax incurred by the debtor rather than by
18 the estate is because Congress expressly said in the
19 legislative history, which is cited in our brief, that
20 they expected the confirmation time to be relatively
21 quickly in a chapter 13 case.

22 We know that they made the same assumption
23 in the chapter 12 case because, one, they enacted the
24 same separate taxable entity rules; and, two, they put
25 in actual deadlines in the code for chapter 13: 90 days

1 to propose a plan, 45 days to confirm it. So, roughly
2 4 months is what Congress had extended.

3 Now, in practice, it's been the case that
4 bankruptcy courts have extended that time beyond the
5 statutory deadlines. So, perhaps they are open a couple
6 months longer than what Congress had expected. But that
7 wasn't the intent that Congress had enacted this with,
8 and if Congress wants to change that, it can go back and
9 rewrite the rules to -- to make that change.

10 JUSTICE SOTOMAYOR: Counsel, before you
11 finish, could you answer my question of what impact your
12 broader reading, your chapter 12, affects only
13 prepetition debts? What else is that kind of holding
14 going to affect? Your narrow alternative holding
15 affects just this issue. That broader reading -- I
16 worry about a broader reading when I don't know its
17 impact.

18 MR. SHAH: I don't think it would have -- I
19 think -- I don't think it would have any adverse
20 effects. And the reason is this: The administrative
21 expenses, whether they're included in the plan or not,
22 are still going to be paid up front. If you take
23 Petitioners' reading that administrative expenses are
24 really part of the plan under 1222(a)(2), rather than
25 1226(b)(1), you now have a conflict between 1226(b)(1),

1 which is on page 10a, which expressly addresses and only
2 addresses administrative expenses, and states that --
3 this is on page 10a. It states those will be paid
4 "before or at the time of each payment to creditors
5 under the plan."

6 Now, if you also said that they come under
7 1222(a)(2), which is the only way that Petitioners could
8 win -- if they also came under 1222(a)(2), 1222(a)(2)
9 says that their -- they must be provided for full
10 payment in deferred cash payments. So, deferred
11 interest-free payments over the life of a 3- to 5-year
12 bankruptcy plan. That's very different than having them
13 get super-priority treatment under 1226(b)(1) and be
14 paid in front -- up front, separate from the plan.

15 So that -- that is one significant piece of
16 textual evidence that Congress thought that these should
17 be paid outside of the plan.

18 The other piece of textual evidence is
19 section 1227(a), which appears on page 10a as well, and
20 what it says is that the confirmed plan shall be binding
21 on each creditor. That's the only potentially relevant
22 category to the government.

23 But section 101 defines "creditor" -- and
24 this is on page 1a of our appendix -- as "entity that
25 has a claim against a debtor that arose at the time of

1 or before the order for relief concerning the debtor."
2 That is a holder of a prepetition claim.

3 If a confirmed chapter 12 plan is only
4 binding on the holder of a prepetition claim, it makes
5 no sense to include postpetition claims within a
6 chapter 12 plan. I don't even know what it would mean
7 to have a confirmed -- to have a plan included that and
8 not have that plan binding on the government.

9 And so, I think if you take those two pieces
10 of textual evidence together, I think that strongly
11 supports the interpretation of 1222(a)(2) that when it
12 says a claim of the type specified in section 507, it
13 means "claim" and doesn't mean "claim and administrative
14 expense."

15 Now, admittedly, Congress has not been
16 perfectly clear in using that term. It uses --
17 sometimes it uses the term "claim" to mean claim and
18 administrative expense. Sometimes it means it to only
19 mean claim. But we should give effect to the
20 distinction between claim and administrative expense in
21 light of section 1226(b)(1), which specifically already
22 addresses administrative expenses.

23 JUSTICE SOTOMAYOR: But the problem with
24 that argument is that the two are used interchangeably
25 by everyone. Congress, the Court --

1 MR. SHAH: Yes, Your Honor.

2 JUSTICE SOTOMAYOR: The government in many
3 situations, given the broad definition of "claims" --

4 MR. SHAH: Sure.

5 JUSTICE SOTOMAYOR: -- the only logical
6 conclusion is that it includes a subset, a liability
7 created by administrative expenses.

8 MR. SHAH: Your Honor, and if you are only
9 construing that language in isolation, if it only said
10 "claim" in 507(a)(2) and 1226(b)(1) didn't exist, I
11 would be in full agreement with you that you would read
12 it to mean "claim and administrative expense." Because
13 we know that administrative expenses have to be paid in
14 some way through a bankruptcy case.

15 But 1226(b)(1) does exist in this code, and
16 we need to give that provision effect.

17 The last point I would make is Congress
18 knows how to include administrative expenses within a
19 bankruptcy plan when it wants to. If you look at the
20 corresponding provision in chapter 11, as opposed to the
21 provisions in chapter 12 and 13 -- this is section
22 1129(a)(9)(A) -- it expressly provides for the payment
23 of administrative expenses within the context of the
24 chapter 11 plan. Chapter 12 and 13 take a different
25 approach, and the Court should give effect to the choice

1 that Congress made to treat administrative expenses
2 outside of the bankruptcy plan.

3 If there are no further questions?

4 CHIEF JUSTICE ROBERTS: Thank you, Mr. Shah.

5 MR. SHAH: Thank you, Your Honor.

6 CHIEF JUSTICE ROBERTS: Ms. Freeman, you
7 have 2 minutes remaining.

8 REBUTTAL ARGUMENT OF SUSAN M. FREEMAN

9 ON BEHALF OF THE PETITIONERS

10 MS. FREEMAN: Your Honor, one of the first
11 things that Mr. Shah said was that the debtor should
12 have set aside \$29,000 from the sale proceeds to pay the
13 taxes. That's \$29,000 in sale proceeds are property of
14 the estate. And, yes, those are ordinarily set aside to
15 pay the taxes. That's how bankruptcy cases work.

16 Because you have 1222(a)(2)(A), that \$29,000
17 didn't need to be used to pay the taxes, and instead was
18 set aside to be treated under the plan of
19 reorganization, where that tax claim could be demoted in
20 priority to a prepetition claim and discharged.

21 But the ordinary course is that the sale
22 proceeds are used to pay the taxes, the administrative
23 expenses. That's how bankruptcy works. And the
24 Government's argument here completely undercuts that.

25 With respect to section 1305, the language

1 is different because it uses the word "payable." It
2 includes all postpetition, postconfirmation, all the way
3 through to the end of the bankruptcy case. Not just the
4 short period of administration.

5 In chapter 13 cases, you still have to pay
6 administrative expenses. It's just that it's pretty
7 rare that you have a tax that is incurred during that
8 short period of administration. And so, you have a
9 separate statute that covers the whole period through
10 the entirety of the plan of reorganization.

11 The Court was -- Mr. Shah was asked about
12 cases where -- and in fact an administrative expense
13 claim was incurred for a capital gains tax in a
14 chapter 12 case. We would cite the Court to the Specht
15 case. A copy of that is attached to the professors'
16 amicus brief. And that shows where a plan was defeated
17 because of the large capital gains tax from the sale of
18 the family farm. And that, in fact, is cited in some of
19 the -- some of the legislative -- not the legislative
20 history, but some of the commentary about one of the
21 reasons why Senator Grassley supported section
22 1222(a)(2)(A) and drafted it in the first place.

23 This prevents a plan from being confirmed.
24 In so many chapter 12 cases, family farmers are not able
25 to go through with their plans. And that's why you have

1 the demotion in priority.

2 It does have very little practical value if,
3 in fact, it only applies to prepetition sales -- and not
4 just prepetition but more than a year prepetition in
5 most instances. The professors' amicus brief just
6 refers to prepetition, and its little chart doesn't say
7 that those are not within the scope of 507(a)(8), and
8 those eighth priority -- I'm sorry, Your Honor.

9 CHIEF JUSTICE ROBERTS: Thank you, counsel.

10 The case is submitted.

11 MS. FREEMAN: Thank you.

12 (Whereupon, at 11:03 a.m., the case in the
13 above-entitled matter was submitted.)

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